

Message Text

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INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-07
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FM AMEMBASSY OTTAWA
TO AMEMBASSY PARIS IMMEDIATE
INFO SECSTATE WASHDC 3964
AMCONSUL MONTREAL
ALL OTHER AMCONSULS CANADA POUCH

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TAGS: ECON, EFIN, CA
SUBJECT: OECD EDRC ANNUAL REVIEW OF CANADA JUNE 30

REF: OECD PARIS 15465, 27295, EDR(77)15

1. SUMMARY. EMBASSY DOUBTS UTILITY IN EXTENSIVE EDRC
DEBATE OVER PAST EFFECTIVENESS OF CANADIAN ANTI-INFLATION
PROGRAM (AIP) AND OF COMPLEX QUESTIONS OF ECONOMIC
STRUCTURE RAISED BY SECRETARIAT, BUT COMMITTEE MIGHT
USEFULLY EXAMINE OTHER QUESTIONS RELATED TO CURRENT
ACCOUNT AND MONETARY POLICY. END SUMMARY.

2. AS MISSION AND DEPARTMENT AWARE, GOC HAS TAKEN STRONG
EXCEPTION TO THRUST OF SOME OF SECRETARIAT'S ANALYSIS
OF PAST TRENDS AND ITS POLICY PRESCRIPTIONS FOR CANADIAN
ECONOMY. WHILE ACKNOWLEDGING SECRETARIAT DOCUMENT
ISSUED UNDER ITS OWN AUTHORITY, GOC (DAVID SLATER,
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DEPT. OF FINANCE, AND ROSS WILSON, BANK OF CANADA)
SUBMITTED EXTENSIVE COMMENTARY AND CRITIQUE OF REFD
TO SECRETARIAT (ANDERSON) THREE WEEKS AGO. ALTHOUGH
COMMITTEE EXAMINATION OF CANADIAN ECONOMY WILL STILL
BE BASED OSTENSIBLY ON FIRST DRAFT OF REFD, WE UNDER-
STAND SECRETARIAT HAS PREPARED REVISED DRAFT UPON WHICH
CANDEL WILL BE COMMENTING AT JUNE 30 MEETING.

3. WHILE HAVING PROBLEMS WITH MANY SPECIFICS, THREE GENERAL AREAS IN FIRST DRAFT WERE OF PARTICULAR CONCERN TO GOC - EFFECTIVENESS OF THE ANTI-INFLATION PROGRAM (AIP); MONETARY POLICY; AND PRESCRIPTION FOR DEALING WITH SECULAR DETERIORATION IN PARTS OF THE CURRENT ACCOUNT BY EMPHASIZING DEVELOPMENT OF RESOURCED BASED INDUSTRIES.

A. AIP. SECRETARIAT CRITICAL BY IMPLICATION (PARAS 15-17 REFD0C) OF AIP'S EFFECTIVENESS, POINTING OUT THAT MUCH OF SLOWING OF INFLATION IN 1976 WAS DUE TO EXOGENEOUS FACTORS SUCH AS GOOD WEATHER AND CROPS, WHILE THERE WAS NO DECELERATION IN WEEKLY EARNINGS IN MANUFACTURING AND HIGH RATES OF INCREASE IN UNIT LABOR COSTS CUT INTO PROFITS. WITH OPPOSITION BY ORGANIZED LABOR AND MANY BUSINESS GROUPS TO CONTROLS, GOC UNDERSTANDABLY DEFENSIVE ABOUT AIP'S EFFECTIVENESS AND INSISTS ITS PERFORMANCE MUST BE MEASURED OVER LONGER TIMEFRAME THAN ONE YEAR. PERFORMANCE CAN PROBABLY BE MEASURED BEST ONLY AFTER CONTROLS COME OFF (PROBABLY BEGINNING LATER THIS YEAR) TO GAUGE WHETHER INFLATIONARY PRESSURES WERE ONLY SUPPRESSED TEMPORARILY BY CONTROLS. GOC NOW DEVELOPING MODALITIES FOR DECONTROL, INCLUDING PROPOSALS FOR MONITORING AGENCY FOR JAWBONING AND CONSULTATIVE GROUP FOR PUBLIC EDUCATION AND CONSENSUS BUILDING AMONG LIMITED OFFICIAL USE

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DIFFERENT INTEREST GROUPS, IN ORDER TO AVOID WAGE-PROFIT-PRICE "BUBBLE" AFTER MANDATORY CONTROLS ARE LIFTED. POST CONTROL PROGRAM WILL PROBABLY BE ANNOUNCED IN LATE JULY. HOWEVER DUBIOUS IT MAY BE, PAST EFFECTIVENESS OF AIP NOW GOC ARTICLE OF FAITH AND NEARLY IMPOSSIBLE TO PROVE OR DISPROVE CONCLUSIVELY. ONLY TIME WILL TELL IF GOC SUCCESSFUL IN DEGASSING THE BUBBLE. WE DO NOT RECOMMEND COMMITTEE BELABOR ISSUE.

B. CANDEL CAN BE EXPECTED TO BE DEFENSIVE ABOUT SECRETARIAT SUGGESTION THAT MONETARY POLICY WAS TOO RESTRICTIVE IN 1976. GOC VIEWS DECLINE IN SECOND HALF OF 1976 WHICH PUSHED RECOVERY OFF TRACK AS DUE LARGELY TO UNFORESEEABLE FACTORS BEYOND ITS CONTROL--ESPECIALLY THE "PAUSE" IN THE U.S. AND ELSEWHERE--RATHER THAN TO OVERLY RESTRICTIVE POLICIES. HOWEVER, WE RECOMMEND COMMITTEE SEEK CANDEL'S VIEWS IN SOME DETAIL ON ITS UNDERSTANDING OF PAST MONETARY PERFORMANCE AND ASSUMPTION CONCERNING CURRENT POLICY STANCE. WHAT FACTORS DOES IT BELIEVE HAVE CONTRIBUTED TO SLUGGISH GROWTH IN M-1? WHAT RELATIVE IMPORTANCE DOES IT ATTACH TO INSTRUMENTS OR TARGETS OTHER THAN M-1 GROWTH? WHAT IS BANK OF CANADA'S

QUANTITATIVE JUDGMENT RE TREND OF VELOCITY?

C. RECOMMENDATION IN SECRETARIAT DRAFT THAT POLICIES SHOULD ENCOURAGE NATURAL RESOURCE BASED INDUSTRIES AS MEANS OF IMPROVING CURRENT ACCOUNT (PARTICULARLY SECULAR GROWTH OF SERVICE ACCOUNT DEFICIT) RAISES EXTREMELY COMPLEX QUESTIONS OF CANADA'S INDUSTRIAL STRUCTURE. NATIONAL POLICIES TO DEAL WITH SUCH ISSUES MUST INCLUDE INTER ALIA REGIONAL AS WELL AS SECTORAL PROBLEMS AND INTERESTS. ATTEMPTS TO DEAL WITH SUCH VAST ISSUES IN EDRC FORUM WOULD SEEM TO BE OF LIMITED USEFULNESS.

4. WITH SOME NOTABLE EXCEPTIONS (E.G., QUEBEC'S OLYMPIC

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DEBT) WE SEE LITTLE CONVINCING EVIDENCE THAT CANADIAN BORROWING HAS NOT BEEN FOR PRODUCTIVE PURPOSES AS SUGGESTED BY SECRETARIAT. WE SEE NO EVIDENCE FOREIGN BORROWING HAS LOWERED DOMESTIC SAVINGS RATES. HOWEVER, WHILE FOREIGN BORROWING MAY PROMOTE THE OBJECTIVE OF GREATER DOMESTIC OWNERSHIP OF INDUSTRY, GROWING DEBT SERVICING WHICH RESULTS INTRODUCES GREATER RIGIDITY INTO THE SERVICE ACCOUNT THAN DIVIDEND PAYMENTS ON EQUITY. OFFSHORE BORROWING IN 1976 IS LIKELY TO ADD OVER ONE-HALF BILLION TO DEBT SERVICING, NOT COUNTING ADDED COSTS FROM EXCHANGE RATE DEPRECIATION. PERHAPS CANDEL COULD COMMENT ON GROWTH OF DEBT SERVICING, INCLUDING ANY QUALITATIVE OR QUANTITATIVE ASSESSMENT OF

WHEN SUCH RIGIDITY MIGHT IMPOSE POLICY CONSTRAINTS.
ENDERS

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